Views differ on needs for retirement

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One difficulty of retirement planning is estimating the future retirement income needs of the individual or couple. Many times, such calculations are based upon an assumed percentage (such as 80 percent) of present living standard expenses, but as actual retirement may be years or even decades away, determining future income needs is not an exact science. At best, the figures tend to be rough "guesstimates" based on assumptions of potential lifestyle consistencies, stripping out obligations (college, home mortgage, child dependency) that should be completed by retirement, and estimations of potential retirement activities and their costs.

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In a recent Fortune article (June 25), two economists, Lawrence Kotlikoff and Jonathan Skinner, took up this debate with polar-opposite views.

Kotlikoff stated that online calculators are far too limiting in their assumptions of retirement spending habits. According to him, some of these calculators assume pre-retirement spending levels will be consistent into retirement and to age 100 (despite the above-mentioned reductions in spending obligations). He estimates these calculators suggest saving/investment goals to be five times what might actually be prudent. In addition, he says, the calculators also recommend five times too much life insurance coverage for the average household. In his opinion, families who follow these guidelines are perhaps saving too much and buying too much life insurance at the expense of current spending and quality of lifestyle prior to retirement.

Skinner takes the opposite tack. In his research and opinion, future retirees are not saving enough. Skinner points out that the spending of new retirees may not actually drop, despite the mortgage payoff and the children being out on their own. In fact, spending may stay the same or even increase, as retirees decide to travel, indulge themselves and enjoy their newfound freedom from work and child-rearing. He also (rightly) points out that while the mortgage and college costs may be finished, health-care costs may increase as the retired person/couple ages more rapidly.

As a practitioner "in the field," I can see some validity to both arguments. Looking at several online retirement income calculators and software, I can see Kotlikoff's point. Life insurance projections in some of these programs wildly overstate needed coverage and income estimates are certainly limited in their scope versus the real world. While retirees certainly tend to indulge themselves (rightly so) in the first decade of retirement, they also tend to slow their activity and spending in their mid 70s and into their 80s.

On the other hand, it's no secret that health-care costs, especially for seniors, are increasing by double digits each year. Kotlikoff believes low- and middle-income retirees will turn to Medicaid for their long-term care, but government entitlement programs are already deeply in the red and unless drastic measures are taken, the situation is unlikely to improve any time soon. (Paradoxically, Kotlikoff emphasized this very issue in his book, "The Coming Generational Storm"). So Skinner does have a point. It may be up to individuals to save more and obtain insurance for these future costs.

One implicit point in both arguments is the need to undertake some kind of planning for retirement, even if the future is cloudy and uncertain.

In my view, the differences of opinion and life's uncertainty also point to the need to monitor financial and retirement plans periodically to ensure progress is on track and goals are being met, even in retirement as well. As everyone's present and future needs will differ, customized analysis based on each family's situation may be helpful in bridging these differences and creating a workable plan for the future.

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